IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 165 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI
and
Hon'ble MR.JUSTICE A.L.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME-TAX

Versus

SHREE LAXMI TEXTILES & ALLIED CORPORATION

Appearance:

1. INCOME TAX REFERENCE No. 165 of 1988
MR MANISH R BHATT for Petitioner No. 1
MR BB NAIK for Petitioner No. 1
NOTICE SERVED for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE A.L.DAVE

Date of decision: 16/01/2003

ORAL JUDGEMENT

(Per : MR.JUSTICE R.K.ABICHANDANI)

#. Income-tax Appellate Tribunal, Ahmedabad Bench "B" has referred the following question under Section 256(1) of the Income-tax Act, 1961, for the opinion of this Court.

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in allowing the amount of Rs. 65,500/- being the amount paid to the retiring partners as revenue expenditure?"

#. The assessee firm came into existence under the Partnership Deed dated 1.11.76 and was engaged in the manufacture of textile processing machines. For the relevant accounting period ended on 30th June, 1979, the assessee filed Return of income on 2.7.80, showing income of Rs 2,71,516/-. During the course of the assessment proceedings, the assessee claimed compensation paid to the retiring partners of Rs. 65,500/- as business expenditure. The Income-tax Officer, however, held that it was payment of a capital nature and added the amount to the assessee's income. On appeal before the Commissioner of Income-tax, Appeals, it was held that the payment made to the outgoing partners was in the nature of a revenue expenditure. The Commissioner of Income-tax, Appeals, placed reliance on the decision of the Punjab & Haryana High Court in Sukhbir Prashad Vs. CIT, reported in 144 ITR 437. The Tribunal upheld the order of the CIT(Appeals).

#. It was contended on behalf of the Revenue that the amount in question and other amounts were to be paid to the outgoing partners in lieu of their rights and interest released under the terms of the Retirement Deed and, therefore, it could not constitute any expenditure incurred for the purpose of the business of the firm.

#. Under Section 37 of the Income-tax Act, any expenditure not being an expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". The Tribunal held that when the payments in respect of the contingent liability had been made to the four outgoing partners in the accounting periods relevant to the

assessment year, such payments partook the character of revenue expenditure and not of capital expenditure. It was observed that the payment did not carry any element towards consideration of any goodwill to the outgoing partners and should not be treated as capital expenditure.

#. The Deed of Retirement dated 29th June, 1978 shows that the outgoing partners had decided to retire from the partnership and hand over the business to the remaining four partners from 30th June, 1978 on the basis of the terms and conditions of such retirement reduced to writing under the said Deed. The outgoing partners, accordingly, were to cease to be partners with effect from 30th June, 1978. It was recorded that the accounts of the assets and liabilities of the partnership and profit and loss account for the period ending 30th June, 1978 were finalised and agreed upon by the parties and the said accounts were signed by them. Para 2 of the Deed refers to the details of the accounts finalised as per which various payments were to be made to the retiring partners including the sum of Rs. 65,500/which was quantified in the context of the orders which were pending at the date of the retirement of these partners. The assets and liabilities of the firm together with tenancy rights were taken over by the continuing partners. The outgoing partners had no right, title and interest in the assets, liabilities and tenancy rights of the firm name. This was stipulated in Clause 3 of the Deed. It is clear from the stipulations of the Retirement Deed that whatever payments were to be given to the outgoing partners, including the sum of Rs. 65,500/-, which was quantified in the context of the orders which were pending at the date of their retirement were in lieu of their foregoing their right, title and interest in the assets and liabilities, the firm name and all other rights in the firm. It is, therefore, clear that the amount of Rs. 65,500/- which was quantified by the Deed of Retirement for payment to the outgoing partners could not be treated as any expenditure incurred by the firm wholly and exclusively for the purposes of its business and the amount was by its very nature a capital payment.

#. A question similar to the one which has arisen in the present Reference was considered by a Division Bench of this Court in C.I.T.Vs. Standard Maltings and Allied Products Corporation, reported in 226 ITR 1, in which on the basis of the terms and conditions of the deed of retirement and release, it was held that the outgoing partners were made payments in lieu of their right, title

and interest in the partnership firm including in its assets and goodwill. In that case, under the deed, partners had agreed to quantify the amount which was to be paid by the continuing partners to the retiring partners for enabling the continuing partners to acquire the rights and interests of the outgoing partners in the firm and for getting the exclusive right to continue the business of the firm in the firm name. It was held that when the continuing partners had chosen to attribute a specified value to the rights of the continuing partners which were being acquired by the continuing partners under the deed, it was not open to any outsider to say that there was nothing payable to the outgoing partners by the continuing partners and that the outgoing partners had no interest whatsoever in the firm which could be acquired by making any payment. The Court held that the contention of the assessee that the payments were made under the deed by the continuing partners for smooth running of the business of the firm was not warranted in view of the specific terms and conditions stipulated under the deed which described the payments as having been made to the outgoing partners in satisfaction of their legal rights and interests in the assets and goodwill of the firm. The firm not being a distinct legal entity separate from its partners, payment made to the outgoing partners was clearly a payment of capital nature relatable to the settlement of accounts between the partners inter se.

#. In the above view of the matter, we hold that the Tribunal has committed an error in allowing the amount of Rs. 65,500/- paid to the retiring partners, as revenue expenditure. The question referred to this Court is, therefore, answered in the negative in favour of the Revenue and against the assessee. The Reference stands disposed of accordingly with no order as to costs.

[R.K. ABICHANDANI, J.]

[A.L. DAVE, J.]
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